

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department)	
Regarding the Assignment of Interstate)	D.T.E. 04-01
Pipeline Capacity Pursuant to <u>Natural</u>)	
<u>Gas Unbundling</u> , D.T.E. 98-32-B (1999).)	

COMMENTS OF AMERADA HESS CORP.

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Amerada Hess Corporation, (“Hess”), provides natural gas supply to large commercial and industrial customers throughout the Northeast and Middle Atlantic States, and also provides wholesale services to its retail arm, local natural gas distributions companies, (“LDCs”), and other retail service providers. Hess is one of the largest suppliers in Massachusetts and serves customers behind all but two¹ of the Massachusetts LDC city gates. Hess appreciates the Department’s initiative to review the capacity assignment program in Massachusetts at this time and also appreciates the opportunity to offer our comments as an active market participant in the Commonwealth and the region.

I. INTRODUCTION.

The Department issued its Order in Unbundling of Natural Gas Local Distribution Companies’ Services, D.T.E. 98-32B on February 1, 1999 regarding mandatory capacity and slice of system allocation for all customers switching to the competitive market after the order. Mandatory capacity assignment and model terms and conditions, (“Ts&Cs”), associated with transportation were implemented on all LDCs on November 1, 2000. The market and the LDCs have operated under these rules for a full three years and are halfway through the fourth winter under the assignment and Ts&Cs plans. Winter weather during these periods ranged from warmer than normal, to colder than normal, to the 2nd coldest January in 100 years this winter and has offered all market participants a true test of the infrastructure and valuable experience with which to draw from for policies going forward.

¹ Blackstone and North Attleboro.

Many energy industry events have occurred during this period that have also tested the industry, including the collapse and bankruptcy of Enron and the retrenchment of speculative wholesale activities by most of the large market players including Dynegy, Duke and El Paso. Many retail marketers have fallen by the wayside as well; however, in most cases, other market participants have stepped in to serve their customers without disruption of service and continue to operate in the markets.

Some Northeast markets have grown during this time period including New York and New Jersey, while others such as those in Massachusetts and Rhode Island we believe have either declined or remained stagnant. Energy prices have varied widely from commodity prices of less than \$2/Dth to over \$70/Dth. New resources have come on-line including the Maritimes and Northeast Pipeline and its Dracut interconnect with Tennessee, the expansion of Distrigas' capability through resources from Trinidad and Duke's Hubline pipeline that connects Algonquin and Tennessee in the Boston area. FERC has also implemented many changes on the pipelines to improve liquidity in the secondary markets through Orders 637A and B. It has been a dynamic period in the industry. Can we draw conclusions about the future from these experiences? Hess believes that we can and that now is an appropriate time to review capacity policies in Massachusetts.

II. EXISTING CAPACITY ASSIGNMENT PROGRAM PROBLEMS

Before any plans to transition out of the mandatory assignment program are reviewed, it is important to address important deficiencies in the existing program. The existing capacity assignment system is in great need of overhaul as soon as can be practicably affected. Slice of system assignment is administratively burdensome, is prone to errors in nominations and

confirmations by marketers, LDCs and pipelines, strands capacity, and weakens reliability. Monthly recall and re-release of each capacity contract also devalues the capacity to the marketer. We will address slice of system first and then monthly recalls and re-releases.

A. Slice of System

The slice of system methodology for allocation of capacity to suppliers was determined by the Department in Unbundling to be the most cost equitable approach for suppliers to enter the Massachusetts market. The Department also wanted to ensure that those customers who migrated first would not have a disproportionate ability to select the most desirable paths than would those who migrated later. D.T.E 98-32-B, p.34-35. Although Hess agrees with the theoretical structure that each marketer should enter the market on the same cost basis, Hess would emphasize that the slice of system method has created additional costs to the marketer not shared by the LDCs, and has also created administrative burdens for both the marketers and LDCs.

Capacity released to marketers is a percentage of the LDC's contracts and overall portfolio. Many contracts may be for small quantities and still commercially viable for the LDC, but become fragmented as they are released to marketers who have a much smaller share of the market than the LDC. It is not unusual to see assigned capacity contracts for 10 Dth or less from any Massachusetts LDC. Marketers must simply strand these fragmented contracts because their small size and the large number of other contracts makes it near impossible to confirm all of the releases during a very short period of time on a daily basis and still have the ability to position gas to flow for the upcoming month. In addition to the administrative effort required to apportion gas to each of these tiny fragmented contracts, fuel is required to move gas from the pooling points to the city gate. In assessing fuel, the pipeline takes a percentage of the gas the

marketer, or any shipper, delivers to the receipt point in order to fuel compression to transport the gas to the delivery point. Fuel rates average about six percent of the amount of gas flowed. However, pipelines do not allocate fuel on a fraction of a Dth, so if fuel is assessed to a contract of 5 Dth, it will be in the amount of 1 Dth, or a rate of 20% instead of 0.3 Dth or 6 percent. When all of the pieces are added up, the marketer with assigned capacity is paying a much higher fuel cost than is the LDC. Due to time constraints for nominations and additional costs associated with fuel, it makes more sense in many cases to simply strand these small pieces. This results in assets for which there is no use, but which carry a cost, thereby further increasing the average cost of the marketer's portfolio.

Additionally, the plethora of contracts for which nominations must be made on a daily basis creates the opportunity for significant numbers of nominating errors, requiring both marketers and LDCs to scramble to make daily corrections to ensure the right amount of gas has reached the LDC's system. This potential for error can directly impact reliability during peak days.

In Hess' experience, because of the number of contracts that must be apportioned and the small size of those contracts, the slice of system method increases the average cost assigned to marketers vis-à-vis capacity held for the LDC's firm sales customers and may also impact reliability. The notion that a pro rata slice of system equitably distributes costs to all marketers has proven to be false. Marketers have higher average costs than the LDCs due to stranded, fragmented capacity, and marketers with a small market share have higher average costs than marketers with larger market shares for the same reasons.

An example of the number of contracts a marketer must stream gas through to nominate for and account for is included as Exhibit AHC- 1. This exhibit compares actual December, January and February capacity assignment contracts managed by Hess for load on four pipelines in

Massachusetts, as compared to contracts managed for load in Rhode Island and New York, which operate on a path basis. The summary on the bottom of the exhibit illustrates the disproportionate number of contracts managed in Massachusetts vis-à-vis the other two states due to the method of capacity assignment. Hess managed over 70 contracts each day for the months of December 2003 and January 2004 in Massachusetts² versus 13 for 25 percent more load in New York where there are a similar number of LDCs, and only two in Rhode Island for roughly half the load of that in Massachusetts.³ Hess cannot emphasize enough that this system must be streamlined as expeditiously as possible for efficiency, reliability and cost reasons, as well as to further encourage a competitive market.

Adoption of a path approach where an LDC would release only one long-haul contract and one short-haul and storage contract per pipeline to each marketer would alleviate the concerns regarding administrative inefficiency, and fragmented and stranded capacity. Cost inequities can be eliminated through charges or credits to marketers for the difference in cost between the capacity path assigned to them and the average cost of all capacity on that pipeline. This method is used in New York and Rhode Island and has been used by Bay State Gas in its residential pilot program in the mid 1990's. Such a structure ensures cost equity and allows LDCs and marketers to more efficiently manage a release program. To address the Department's concern that early entrants will receive the more advantageous pieces of capacity, paths should be determined and released annually. There is no need to delay the move to a path approach while deciding other issues. Movement to a path approach should be accomplished as soon as possible to avoid perpetuating the gross inefficiencies of the slice of system capacity release program.

² This exhibit does not include storage contracts or the contracts that were stranded by Hess. Inclusion of these contacts would increase the number of contracts to over 100.

³ We note that in Connecticut, the LDCs and Marketers have specifically agreed in a Settlement to Docket No. 97-07-11PH02 to avoid any discussion of a slice of system approach in the event it is determined a capacity assignment system is warranted.

Switching from a slice of system to a path approach should reduce overall administrative effort and could be accomplished over a fairly short period of time. It should take little effort to develop a path system, as several models already exist that could be adopted. Paths could be assigned once per year with average costs and the charge or credit can also be calculated once per year freeing both the LDC and marketer to perform more productive tasks. The path approach will put LDCs and marketers on the same cost basis and transportation customer prices will reflect the more efficient administration and path costs utilized to serve them. No one is harmed by this change in methodology; marketers and LDCs' processes are more efficient and customer prices will reflect these efficiencies. Hess requests the Department to change its policy as soon as practicable to allow the market to operate on a path basis before the start of next winter.

B. Monthly Releases and Recalls

Another capacity assignment program practice that carries burdensome administrative inefficiencies and also causes economic harm to marketers and their customers is the practice of LDCs recalling and re-releasing all assigned capacity to marketers every month. Marketers cannot maximize the value of the capacity if it can only rely on having it for one month at a time. Monthly recall and re-release of every contract takes away all flexibility marketers might have to work the greatest value out of these resources while at the same time, customers lose price efficiencies. Capacity assigned to marketers in Massachusetts is therefore worth less than capacity held by the LDCs.

If the LDCs were to instead calculate and release a baseload level of capacity associated with the marketer's load for a year, and only execute monthly recalls and re-releases of incremental levels of capacity, marketers could then manage multiple month value added strategies in the off-

peak periods. New York employs this baseload method of assignment, with incremental recall and release.

Hess urges the Department to require the LDCs to adopt the New York method of recall and release as it will improve efficiencies for both LDCs and marketers and will give marketers a closer approximation of the value of the capacity held by the LDCs. Customers will benefit as their prices reflect this value. Annual baseload releases could be implemented in a short period of time. It only requires the LDC and marketer to agree on the baseload amount. Incremental capacity will be recalled and released as it is today. This change should be made in conjunction with a change to a path method as discussed above.

C. Other Program Issues

As stated earlier, marketers have almost three and one-half years of experience operating under the standard Ts&Cs. In most respects, the Ts&Cs were well crafted and have expanded the Massachusetts market because all LDCs are operating on the same basis, making it more efficient for marketers to operate on multiple LDC systems. During that time frame however, the level of commodity prices has more than doubled and increases geometrically during operational flow order periods, (“OFO”). Pipelines and LDCs call OFOs when the pipelines are operating near their maximums and it is imperative for all shippers to deliver gas as close to their customers’ use as possible. When imbalance penalties were originally established, the price ranges were fairly stable day-to-day and even during OFO periods did not deviate significantly from non-OFO periods. It was under these conditions that the marketers and LDCs agreed on an OFO penalty level of five times the Gas Daily index price for imbalances exceeding the two percent tolerance. This multiplier approximated the level of penalties in the pipeline tariffs at the

time of \$15 per Dth. Now that we have seen gas routinely reach the \$15 to \$25 per Dth level during OFO periods, and range as high as \$75 per Dth, we think it is appropriate to re-evaluate the penalty level. Five times index penalty levels during OFO periods are excessive as for the last several years, the index prices themselves react to periods of system stress. Penalties are intended to give economic incentives for appropriate behavior; however, penalties should not be overly punitive. A marketer who was short by 1 Dth in January 2004 when the index prices reached \$70/ Dth and above, could have experienced a penalty of \$350 for that one Dth. This penalty multiplier is overly punitive. A penalty of \$140 per Dth at two times index is more than adequate to provide the proper incentives for marketers to deliver requirements. It would be appropriate to revise OFO penalty levels in Massachusetts and move to a two times index OFO penalty.

III. TRANSITION OF CAPACITY TO THE COMPETITIVE MARKET

The Department's order in DTE 98-32-B, Unbundling of Natural Gas Distribution Companies Services, identified market conditions that were determining factors in their decision to require mandatory capacity assignment. The Department found that New England was at the end of the pipeline system, with few capacity options, and upstream capacity was leased almost exclusively by LDCs. It concluded that until the number of contract holders with firm rights on interstate capacity increases, and until FERC-imposed price controls on the interstate pipeline are lifted, they will not regard the capacity market as fully competitive.

Hess believes the conditions required by the Department for a fully competitive wholesale market have improved. However, Hess also believes the Department has set up a chicken and egg conundrum with respect to non-LDC capacity holders on the interstate pipelines. If

mandatory capacity assignment did not exist, marketers would have purchased capacity to satisfy their load requirements. The fact that mandatory capacity assignment does exist obviates the need and creates a disincentive for marketers to purchase any capacity for that load. Can the Massachusetts market ever reach the level of marketer held capacity the Department requires to declare the wholesale market competitive if Massachusetts maintains such strict assignment requirements? Hess believes the Department needs to allow the market to develop by gradually releasing the grip that mandatory assignment has placed on it.

Hess will discuss the changes that have taken place in the market over the last four years below, and will also make recommendations regarding the Massachusetts program that could allow the market to begin to transition gradually.

A. Changes in the New England Gas Supply Industry Since 1999.

Several Major structural changes occurred in the New England market since the Department issued its order in Unbundling. Distrigas, the region's LNG supplier began importing LNG from Trinidad, in addition to Algeria, in 1999 in substantially greater volumes than had been imported from only Algeria previously. Imports have continued to increase from 98.8 Bcf in 2000 to over 150 Bcf in 2003.⁴ Trinidad is much closer to Boston than Algeria, allowing ships to make more deliveries in the same time period. Distrigas also increased vaporization capacity from 435 Mcf per day to 700 Mcf per day in 1999. Increased year-round LNG supply has given the region more market area resources.

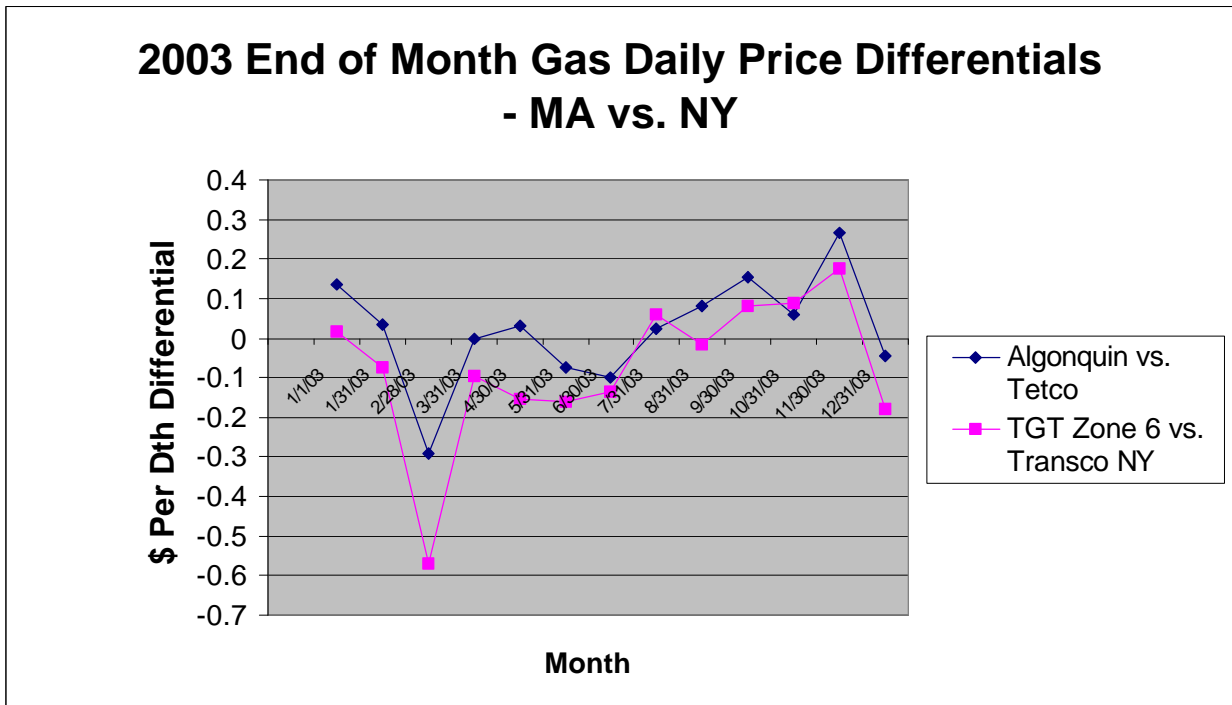
In December of 1999, the Maritimes and Northeast Pipeline, ("MNE"), interconnecting with Tennessee in Dracut began to flow. This brought 530,000 MMBtu per day of increased

⁴ Source: Cambridge Energy Research Associates and US Department of Energy. December 3, 2003, Eastern North America Energy CERA Monthly Briefing.

capacity into the back-end of the Tennessee pipeline system, reinforcing pressures and allowing for greater deliverability to the New England market. MNE has changed both supplies and prices into New England. Prior to MNE's onset, the market price of gas delivered into New England always traded at a premium over gas delivered upstream in the New York City and M3 areas. New York City and M3 have long been considered liquid markets. Because Massachusetts was at the end of the pipeline, the difference between New York and Massachusetts prices included the transportation costs from New York. This premium typically reflected the rates on Algonquin, which moves gas from New York to Massachusetts.

With new resources coming in from the north along with the Distrigas expansion, the market value of delivered prices to New England no longer reflect a New York delivered price plus transportation. The price differential is now nearly always less than the cost of transportation on Algonquin and is even negative during much of the year, which means prices of gas delivered to Boston are less than prices of gas delivered to New York. This is indicative of a higher level of competition on the wholesale level in New England and Massachusetts than was experienced at the time of the Department's order in Unbundling, when delivered prices into Massachusetts typically reflected the NY-MA transportation premium. Graph 1 below shows the end-of-month price differential between New York and Massachusetts delivery points for 2003.

Graph 1



Points below the zero axis indicate periods when prices in Massachusetts are lower than prices in New York; conversely points above the zero axis indicate periods when New York Prices were lower than Massachusetts prices.

B. Competition on the Interstate Pipeline System.

1. Primary Market Capacity

Competition has increased on the Interstate Pipeline system into Massachusetts and New England since February 1999. As mentioned above, there are more resources coming into the region, in addition to many new market participants, other than LDCs and power plant owners, who have purchased capacity into the region. Table A below lists all non-LDC and non-power generator capacity holders on the Algonquin and Tennessee pipelines with delivery points in New England.

Table A
Non-LDC and Non-Power
Generating Capacity Holders

	Tennessee	Algonquin
AMERADA HESS CORP	51,000	13,000
BRYMORE ENERGY LTD.		14,010
DUKE ENERGY TRADING AND MKTG, LLC	408	
CAPITOL DISTRICT ENERGY CENTER	3,220	
COLONIAL ENERGY, INC.	15,000	
CONSTELLATION POWER SOURCE, INC.	26,300	
DISTRIGAS OF MASSACHUSETTS LLC	110,000	110,000
EL PASO MERCHANT ENERGY, L.P.	105,000	
ENERGY EAST SOLUTIONS, INC.	10,400	
IROQUOIS GAS TRANSMISSION SYSTEM	37,000	13,000
NORTHEAST ENERGY ASSOCIATES		62,000
ORCHARD GAS CORPORATION	25,000	
PHELPS DODGE COPPER PRODUCTS CO		3,800
SELECT ENERGY, INC.	12,500	
SEMPRA ENERGY TRADING CORP.	13,000	
SEQUENT ENERGY MANAGEMENT, LLC	2,003	
SPRAGUE ENERGY CORPORATION	21,200	
TXU PORTFOLIO MANAGEMENT COMPANY	20,000	20,000
US GYPSUM		1,600
Total Non-LDC, Non-Power Generating Capacity	452,031	237,410
Total Capacity Held	1,887,229	2,337,374
Percent Held by Non-LDCs and Non-Generators	24%	10%

Sources: Tennessee Gas Pipeline Index of Customers: January 2004.
Algonquin Gas Transmission Index of Customers: January 2004.

Total capacity on the Tennessee Pipeline with New England citygates is 1,887,229 Dth. On Algonquin, it is 2,337,374 Dth. Non-LDC and non-power generators hold twenty-four percent of the capacity on the Tennessee Pipeline and ten percent of the Algonquin Capacity. The existence of this level of non-LDC capacity holders directly addresses one of the Department's metrics for determining if there is wholesale competition. This table proves that both Tennessee and Algonquin are well on their way toward transitioning pipeline capacity to other market participants.

Amerada Hess has been operating in the New England area for more than 3 years as both a retail and wholesale supplier. Hess has purchased primary point capacity for its customers in Massachusetts and New England on the Hubline, Algonquin and Tennessee pipelines for anywhere from one to three years, with rights of first refusal, (“ROFR”). It has been Hess’ experience that capacity has been readily available in the open season markets on Tennessee, whereas capacity on Algonquin is more difficult to come by. Although Hess has been able to procure some Algonquin capacity, the Algonquin delivery points are not as liquid as the Tennessee points. Capacity on points upstream of Algonquin is highly liquid and is readily available. It is Hess’ experience that more capacity has been available on the market since the Department last reviewed the situation in 1998 and since the collapse of the speculative wholesale marketers, making it easier for retail suppliers to pick up capacity they need to serve their customers. Other than the Algonquin pipeline capacity, most of the rest of the capacity held by the Massachusetts LDCs has substitutes in the market.

Additionally, there is still capacity held by LDCs in New England that is not being used to serve firm load. This includes capacity being held by LDCs for growth, and excessive levels of capacity some LDCs perceive is required to backstop load that has moved to the competitive market. It is Hess’ position that this surplus capacity should be turned back for the pipelines to re-market or should be released to the secondary market on a non-recallable basis until it is again needed. This would further improve liquidity on the regional pipelines.

2. Secondary Market Capacity and Delivered Gas

There is no shortage of resources if a marketer needs to pick up spot purchases delivered to specific city gates. Even in January of this winter, during what was reported as the second

coldest January in one hundred years, gas was available at any city gate in New England for a price. While prices reached very high levels, especially on the 15th of January, spot resources were available.

Although the FERC experiment in Order 637 allowing short-term secondary releases to be made at rates exceeding pipeline tariff rates was terminated after a two year test period, the market has improvised and circumvents this restriction daily through delivered gas sales. These sales include the cost of gas plus the cost of transportation to the delivery point plus a premium or discount reflecting the difference between the tariff rate and the market value of the capacity. Gas Daily posts the price of delivered gas into New England points on a daily basis. One only needs to subtract the Henry Hub price to derive the market value of the transportation on any given day. On days this winter, spot gas sold at a multiple of tariff rates.

3. Retail Competition in Massachusetts Vs. Other States.

In addition to reviewing competition in the wholesale market, Hess believes it is dispositive to look at competition in retail markets, and to compare states to identify success elements and barriers. From our experience in working in the Massachusetts market, there is a single identifiable structural barrier in the Massachusetts program, and that is simply identified as mandatory capacity assignment. The other elements of the program including statewide standardization of tariffs have been beneficial to the development of the market that is operating in the state. However, mandatory assignment is such an overwhelming barrier that only a few marketers have been able to brave this market, and are only sustained by a substantial population of customers that has been grandfathered without capacity assignment.

The competitive market in other Northeast states thrives when freed from the encumbrances of a strict mandatory capacity assignment program. When comparing markets with mandatory

assignment, such as Massachusetts, to those without, there is a marked difference in the number of competitors as well as the number of customers and load that has migrated. In New Jersey, where there is no capacity assignment, there are at least sixteen marketers working on each of the four LDC's systems as compared to seven in Massachusetts. Nine percent of the non-residential customers and five percent of residential customers have switched in New Jersey. See Exhibits AHC- 2 and 3.

In New York, there is a limited capacity assignment program. Mandatory capacity assignment exists only where there are single pipelines serving an area, primarily in upstate New York. There is no capacity assignment upstream of interconnects that have been determined to be liquid pooling points. Liquid pooling points are defined as areas where capacity and/or delivered gas is readily available. These interconnects are located primarily in New York and Pennsylvania.

Upstate New York is similarly situated to New England in that they both are at the end of the pipeline. The Dominion Pipeline System is the primary pipeline system serving Rochester Gas & Electric, ("RG&E"), Niagara Mohawk, ("NIMO") and New York State Electric and Gas, ("NYSEG"). Other pipelines feed the Dominion system, but most of the LDC citygates are on Dominion. This is not unlike Massachusetts, which has the Algonquin and Tennessee pipeline systems serving the LDCs in the Commonwealth; however, Massachusetts has more flexibility to move gas across the system than has upstate New York, with the MNE/Tennessee Dracut interconnect, Hubline and more Distrigas take away capability.

Even with their end-of-the pipeline situation, New York has been able to make a limited capacity assignment program work. Sixteen percent of non-residential customers and thirty-two percent of non-residential load have switched, and seven percent of residential customers and

thirteen percent of residential load have switched. See Exhibit AHC- 2. There are also at least sixteen marketers working on each upstate New York LDC, which is more than twice the number of competitors in Massachusetts (seven). See Exhibit AHC- 3.

Unfortunately, public data for Massachusetts switching is not as easily obtainable so Hess is unable to make switching comparisons at this time. The LDCs do report monthly data to the Department of Energy Resources, however, it is not published on a website as is data in other states. Although we have no hard data, our market experience indicates that there is much less activity in Massachusetts and it does not appear that the Massachusetts market is growing. One can conclude however, that longer term, if capacity assignment rules are modified along the lines of those in place in New York, the number of competitors in the Massachusetts market will increase, and most surely, competitive market share will increase. Hess would like to assist the Department in realizing these objectives, as a robust competitive market benefits all participants.

Hess recognizes that the Department has clearly articulated objectives for competition⁵, and that it had concerns regarding reliability and cost subsidization when it issued its order in D.T.E. 98-32B. We are fully cognizant of those issues and our recommendations will address both reliability and cost issues.

It is due to all of the above evidence that Hess concludes it is the right time for Massachusetts to consider new policies to begin to transition capacity into the marketplace and to move away from the 100 percent mandatory capacity assignment policies that have established substantial barriers to competition in the Massachusetts market. Easing of these requirements will allow

⁵ ...to: (1) provide the broadest possible customer choice; (2) provide all customers with an opportunity to share in the benefits of increased competition; (3) ensure full and fair competition in the gas supply market; (4) provide functional separation between the sale of gas as a commodity and local distribution service; (5) support and further the goals of environmental regulation; and (6) rely on incentive regulation where a fully competitive market cannot exist, or does not yet exist. Letter from the Department of Public Utilities (now Department of Telecommunications and Energy) at 2 (July 18, 1997).

more customers to participate in the market, satisfying one of the Department's goals for competition, and will allow customers to have choices in pricing and risk management not available to them from LDCs. A more competitive retail energy market will be beneficial to economic growth and consumers in the Commonwealth. It will allow businesses to cut or stabilize energy costs and may encourage employers to stay in the region. We will now present our proposal to enhance competition through a gradual transitioning of capacity from LDCs to marketers.

IV. RECOMMENDATIONS FOR THE DIRECTION OF THE COMPETITIVE MARKET

The Northeast region's wholesale market has clearly improved since the Department last reviewed it in 1998. Most importantly, there are new resources into the region, both of a pipeline and peaking nature and market participants other than LDCs that hold firm capacity in the region. Primary capacity is available on both Tennessee and Algonquin, and short-term releases or delivered gas sales are readily available even on the coldest days.

Hess recommends that the Department allow Massachusetts retail marketers to begin to substitute capacity purchased by marketers and held by marketers for assigned capacity from LDCs. The two tenets behind this proposal are (1) reliability must be maintained on the distribution system, and (2) transitioning of capacity should not involve subsidization from firm sales customers. It is not practical for such a transition to occur all at once and it would be difficult to avoid the creation of stranded costs in a single step transition. Therefore, Hess recommends a gradual transition to coincide with (1) the expiration of key LDC contracts and (2) the time LDCs need capacity for incremental load growth behind their system. Hess proposes that marketers be allowed to substitute capacity purchased by marketers in the market for

capacity assigned by LDCs at these transition points. This proposal will avoid subsidization concerns while providing a gradual, orderly transition, and would work as follows.

Any market capacity purchased by marketers to substitute for LDC assigned capacity must meet reliability requirements to be established jointly by LDCs, marketers and the Department. New York accepts an affidavit from the marketer that its capacity is primary to the LDC's city gate during the winter months. This has served New York well for the last six years and could also be used in Massachusetts. There are two opportunities we have identified for transitioning capacity to the market without creating subsidies for firm sales customers. The first opportunity occurs when existing pipeline contracts expire. The second opportunity occurs when an LDC must purchase additional capacity to accommodate growth on the system.

A. Expiring Capacity Contracts

Each LDC has a portfolio of capacity contracts that expire at different points in time over a period of about ten years. At the time a contract expires, the LDC typically has a few choices; it can renew the contract at the same daily quantities specified by the prior contract, it can allow the contract to expire without renewal, or it can renew the contract for a smaller delivery quantity than specified by the prior contract. Contracts encompass various types of capacity and may come all the way from the gulf to a Massachusetts city gate, or more frequently, they are a segment of that transportation; or they can be for storage in the market areas of New York or Pennsylvania, with associated takeaway capacity to deliver gas from storage to Massachusetts.

Each time a capacity contract from the LDC's portfolio is nearing its expiration date, the LDCs could allow marketers to discontinue taking capacity assigned from any new contract that results. LDCs could allow marketers the opportunity to purchase their own capacity from the

market in lieu of the amount assigned from the LDC contract. Any capacity purchased by the marketer on its own behalf to be substituted for assigned capacity must meet reliability requirements established by the LDCs, marketers and the Department. If the marketer opts to purchase its own open market capacity and turn back assigned capacity to the LDC, the LDC would then reduce the amount of renewal on the pipeline by a corresponding amount.

Table 1 below will help illustrate an example. A hypothetical LDC has a contract on the Tennessee pipeline with a maximum daily quantity, (“MDQ”), of 500 Dth per day and the contract is partially assigned to marketers in the amounts listed in Table B below.

Table B

	V. Contract Amount Dth/day
Total Contract Quantity	500
Marketer A	20
Marketer B	5
Marketer C	40
Marketer D	15
LDC Sales Load	420

Upon expiration of the pipeline contract, the LDC would allow marketers to procure and hold open market capacity up to the amount of their allocation and would not continue to assign capacity from a new contract. Open market capacity must be in place at the time the contract expires. In this case, for example, Marketer A, B and C can purchase open market capacity and present this as an alternative to assigned capacity. Marketer D is unable to acquire open market capacity. The amount of capacity purchased by the marketers would equal the amount of the LDC contract that had been assigned, or 65 Dth per day. The capacity presented by the marketers would necessarily be of sufficient quality to be accepted by the LDC as a substitute for the LDC’s capacity.

The LDC is then able to turn back 65 Dth per day of the original contract upon renewal as the marketers are bringing in 65 Dth per day of their own capacity acquired on the market. The LDC renews the contract for 435 Dth/day of capacity. There has been no harm to reliability as the marketer capacity is of comparable quality to the assigned capacity, and there are no shifted costs to firm sales customers as they continue to be responsible only for the 420 Dth per day used to serve their load. Marketer D continues to be assigned 15 Dth per day of the new contract.

B. Capacity Required for Growth Behind the LDC's System

The other opportunity for transition of capacity comes about as LDCs need more capacity to support growth on their system. LDCs should allow marketers to turn back assigned capacity to satisfy the LDC's growth needs. Marketers could procure capacity in the open market in the amount the LDC needs for future growth and then the marketer would turn back an equivalent amount of assigned capacity.

For example, an LDC determines they are going to be growing at a rate of 500 Dth per day each year over the next five years on the Tennessee pipeline. Under normal circumstances, the LDC may purchase 2500 per day of additional Tennessee capacity and grow into it over the next five years. Instead of purchasing capacity on the open market, the LDC could instead allow marketers to turn back assigned capacity to the LDC to use for its own growth, and then the marketer would procure capacity in the open market to replace the assigned capacity it turned back. This vehicle provides the opportunity for the marketer to hold its own capacity to serve its Massachusetts load, and allows the LDC to grow at its existing cost of capacity and no additional cost is transferred to the firm customer.

For Example, the LDC needs to procure 1000 Dth per day of capacity from somewhere to satisfy its forecasted growth needs. The LDC can ask marketers if they would like to give back 1000 Dth per day of assigned capacity to satisfy the LDC's growth requirement. If the marketers agree to return 1000 Dth per day to the LDC, the marketers need to go to the market for an equivalent amount of capacity to replace the assigned capacity taken back by the LDC. Marketers in total would not be able to turn back more than 1000 Dth per day in this example.

Table C below illustrates the amount of assigned capacity that each marketer would be able to turn back if it was able to procure an equal amount of primary capacity in the market.

Table C

LDC capacity growth needs on Tennessee Pipeline		1000 Dth per day	
	Marketer Load on Tennessee – Dth/day	Percent of Marketer Load	Amount of Assigned Capacity Eligible to Return
Marketer A	500	10%	100
Marketer B	1500	30%	300
Marketer C	2000	40%	400
Marketer D	1000	20%	200
LDC Sales Load	25,000		

In this instance, Marketer A, who holds ten percent of the competitive market load would be eligible to purchase ten percent of the LDC's growth increment of 1000 Dth per day, or 100 Dth per day of capacity purchased on Tennessee and turn back 100 Dth per day of assigned capacity on Tennessee to the LDC to be used to satisfy the LDC's growth requirement. Capacity purchased in the open market would necessarily pass the reliability requirements established in the course of a Department proceeding. Again, reliability requirements are met, and firm sales

customers are no worse off than they would have been had the LDC purchased new capacity in the open market itself.

Hess believes this proposal provides opportunities to transition capacity to the competitive market. It will become more and more apparent which pipelines are liquid as marketers will be able to procure open-season primary point capacity on the pipelines with liquidity and will not be able to acquire capacity in the same quantities on the pipelines with less liquidity. Capacity appropriate to move to the market will move. Capacity for which there are no substitutes will not.

V. CONCLUSION

Hess appreciates the Department's willingness to review the capacity program in Massachusetts and recommends some changes to the program be made at this time. In the short run, the existing slice of system program should be revamped to a path approach. Further, LDCs should release a baseload level of assigned capacity to each marketer for a year and only issue monthly recalls and re-releases on incremental levels of capacity. The Department should also consider allowing marketers to begin to supply their own capacity resources for portions of the LDC portfolio as contracts expire and are up for renewal or as LDCs require additional capacity for system growth. Marketer held capacity would need to meet reliability requirements established by the Department and must not create any new subsidies of competitive market customers by firm sales customers.

Hess also recommends the Department hold a series of technical sessions similar to those held by the Department on the electric side. This will allow a variety of proposals to be discussed and will give the process some structure. Many events have transpired in the industry

over the past 4 years and we may find some common ground between the participants to improve the existing programs and enhance the natural gas competitive market in the Commonwealth.